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In the Supreme Court of the United States

OCTOBER TERM, 1957

VAUGHN C. PAYNE AND EDITH PRUITT PAYNE,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The District Court rendered no opinion. Its findings of fact and conclusions of law (R. 32–39)[1] are not officially reported. The opinion of the Court of Appeals (Pet. 13–23) is reported at 247 F. 2d 481.

JURISDICTION

The judgment of the Court of Appeals (Pet. 23) was entered on August 8, 1957 (Pet. 13). Petition for rehearing was denied on September 17, 1957. (Pet. 2.) The petition for a writ of certiorari was filed on December 6, 1957. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

[1] Record references are to the record filed in the United States Court of Appeals for the Eighth Circuit.

QUESTIONS PRESENTED

1. Whether the Court of Appeals was correct in holding that the United States, in its suit to recover assessed and unpaid income tax deficiencies, 50% civil fraud penalties, and interest, sufficiently pleaded Dr. Vaughn C. Payne's civil tax fraud.

2. Whether Mrs. Payne is liable as a transferee for the taxes, civil fraud penalties, and interest assessed against Dr. Payne to the extent of transfers made to her by Dr. Payne, and whether both spouses are similarly liable to the extent of property transferred by Dr. Payne in entirety.

STATUTES INVOLVED

Sections 276 (a) and (c) and 311 (a) (1) and (b) (1) of the Internal Revenue Code of 1939 are set forth in the Appendix, *infra*.

STATEMENT

This suit was instituted on August 27, 1953 (R. 7), against Dr. Payne and his wife: (a) to have certain deficiencies, penalties, and interest reduced to judgment against Dr. Payne; (b) to have it decreed that two described pieces of real estate, acquired in 1944 and 1945, with title taken and standing in the name of Dr. Payne and his wife as tenants by the entirety, had been purchased with funds of Dr. Payne, had left him without sufficient other assets to pay his outstanding tax liabilities, and had the purpose and result of defrauding Dr. Payne's creditors, including the United States; (c) to have it decreed that a third piece of real estate, acquired in 1947, with title taken and standing in the wife's name, had been purchased with funds of Dr. Payne, constituted a conveyance

and transfer to her without consideration, and had left Dr. Payne without sufficient assets to pay his outstanding tax liabilities; and (d) to have enforced the Government's lien, as well as such other rights the United States had in the circumstances to have the real estate subjected to the payment of the tax liability. (R. 1–7; Pet. 14–15.)

The pertinent facts, as found by the District Court (R. 33–37) and adopted by the Court of Appeals (Pet. 13–16, 20–22), are as follows:

During the years 1942 through 1947, Dr. Payne willfully understated his earned income with the fraudulent intent to evade his taxes.[2] (R. 35; Pet. 15.)

The taxes involved (excepting a small amount thereof) appeared on the assessment list received by the then Collector on July 11, 1949 (less than six years from the date of the filing of the complaint herein). Notice of the determinations, which had been previously made, and demand for payment were properly served on Dr. Payne. Notices of liens were filed on August 12, 1949. The balance owing upon the foregoing assessments, at the time of the trial, was $19,799.21 on account of the 1944 and 1947 assessments, plus interest on all stated assessments for 1942–1947, inclusive, from the dates thereof. (R. 34; Pet. 13–15.)

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[2] The same finding was made as to Mrs. Payne for the year 1942 because she, as well as Dr. Payne, had signed the return for that year. The Court of Appeals reversed, concluding that she had not intended to sign the return as a joint maker. (Pet. 16–18.) The United States has not petitioned for a writ of certiorari from this part of the judgment of the Court of Appeals.

The real properties held by Dr. and Mrs. Payne in entirety were acquired with funds earned by Dr. Payne, and Dr. Payne was made insolvent by the use of his funds to purchase the said real properties for himself and his wife as tenants by entirety. With funds earned by Dr. Payne, his wife, in October, 1947, purchased certain other real property described in the complaint, title to which was taken at that time on behalf of Dr. Payne and his wife in the name of one Samuel E. Morganstern. There was delivered to Mrs. Payne in October, 1947, a general warranty deed to Morganstern from the defendant Marjorie Mitchell Bell and a general warranty deed from Morganstern in which the date and name of the grantee were left blank. The use of Dr. Payne's funds for the purchase of this property in the name of Morganstern again left Dr. Payne insolvent. In 1950, after the deficiency assessments were made against Dr. Payne as herein described, the defendants, Dr. and Mrs. Payne, caused the name of Mrs. Payne to be entered as grantee in the blank deed from Morganstern, and the deed was then recorded. The transfer of the last above described property was made with intent to defraud the creditors of Dr. Payne. (R. 35, 37; Pet. 15.)

The defendants Marjorie Mitchell Bell and Samuel E. Morganstern were served with process in this action, but defaulted. (R. 35-36.)

The District Court held: (a) that Mrs. Payne, and Dr. and Mrs. Payne as tenants by entirety, were liable to the United States as transferees of the assets of Dr. Payne to the extent of the above property; (b)

that the United States was entitled to a reformation of the title of each of the real properties described, vesting such title in Dr. Payne, with whose funds said properties were purchased; and (c) that the United States was entitled to a decree of foreclosure on account of its tax liens. (R. 38, 39.)

Except for the personal judgment entered by the trial court against the wife for unpaid interest on the 1942 deficiency and penalty, the Court of Appeals affirmed the judgment of the District Court in all respects. (Pet. 18, 23.) In so doing, it specifically held (Pet. 20) that the evidence amply supported both the additional assessment of 50% civil fraud penalties, and the trial court's finding that each of the three real property purchases rendered Dr. Payne insolvent.

ARGUMENT

1. The Court of Appeals correctly held that the United States, in its suit to recover assessed and unpaid income tax deficiencies, 50% civil fraud penalties, and interest, sufficiently pleaded Dr. Vaughn C. Payne's civil tax fraud.[3] There is no merit in petitioners' assertions (Pet. 3, 11) that such was not the case.

It has long been established that, for purposes of a collection suit, the additionally assessed 50% statutory fraud penalties—*viz.*, civil additions to tax for failure to report income "due to fraud with intent to evade tax"—are properly collectible as a part of the

[3] Petitioners make no attempt to attack the findings of both courts below that the returns were made with an intent to evade taxes.

assessed income taxes due. *Helvering* v. *Mitchell*, 303 U. S. 391. As the Court of Appeals pointed out (Pet. 20–21), the applicability of Rule 9 (b) of the Federal Rules of Civil Procedure is, at best, doubtful in the case of "a complaint in a suit to collect assessed tax deficiencies and fraud penalties, of which the taxpayer has administratively been given due notice of determination, assessment, and demand for payment." In addition, as part of the complaint in this case, a copy of the assessment list (Ex. 1, R. 5), showing the amounts of the deficiencies and the 50% civil fraud additions, was both attached thereto and expressly incorporated therein by reference. Moreover, Dr. Payne, in his answer, made express reference to the "Ad Valorem 50% Fraud Penalty," while referring, at the same time, to the "Burden of Proof in Fraud Cases." (R. 8–9).

Certainly, as this Court said in *Hickman* v. *Taylor*, 329 U. S. 495, 501, the purpose of the Federal Rules—*viz.*, to "restrict the pleadings to the task of general notice-giving"—was demonstrably satisfied. See, also, 1 Barron and Holtzoff, *Federal Practice and Procedure*, § 302, p. 543, for the proposition that "the sufficiency of a pleading must largely depend upon the nature of the case, the complexity or simplicity of the transaction or occurrence, the relationship of the parties and the determination of how much circumstantial detail is necessary to give notice to the adverse party and enable him to prepare a responsive pleading."

Kithcart v. *Metropolitan Life Ins. Co.*, 88 F. 2d 407 (C. A. 8th), relied on by petitioners (Pet. 6, 11), is not in conflict with the decision below, but is clearly

distinguishable. That case involved a defendant's motion to dismiss a bill of complaint praying that judgment in a prior action at law be set aside on the ground that the plaintiff in the former action, through the fraudulent acts of the defendant, was prevented from producing certain testimony in rebuttal of an affirmative defense interposed by the defendant. The court stated it was not made clear as to just what evidence plaintiff was prevented from producing, nor what acts were committed by the defendant or its representative which it claimed constituted fraud. Here, the Court of Appeals was correct in concluding (Pet. 21):

> In any event, * * * we are satisfied that it [*viz.*, Rule 9 (b)] would not preclude the court from entering a judgment upholding such fraud penalties, where, as here, the question of their validity has been fully tried, where it is clear that the taxpayer knew that the question would be and was being made the subject of trial, and where he raised no objection to the sufficiency of the complaint in this respect until after the conclusion of the trial.

2. There is no merit to the petitioners' contention that judgment can not be sustained against Mrs. Payne as a transferee because no assessment was made against her. The Government may choose either the summary remedy provided in Section 311 of the 1939 Code (Appendix, *infra*, pp. 10–11), which requires assessment against the transferee, or, as here, an equity proceeding brought against the transferee on the trust fund theory, under which it is unnecessary to make any assessment against the transferee. *Leighton* v.

United States, 280 U. S. 506; *United States* v. *Fisher*, 57 F. Supp. 410 (E. D. Mich.); *United States* v. *Prince*, 120 F. Supp. 563 (S. D. N. Y.). *United States* v. *Updike*, 32 F. 2d 1 (C. A. 8th), affirmed, 281 U. S. 489, cited by petitioners, is not to the contrary. That case merely holds that, even where an assessment may be made at any time, the six year statute of limitation within which to institute suit applies to both transferor and transferee where the taxes have been assessed against the transferor. Here, the taxes were assessed against the transferor in July, 1949, and this suit was instituted in August, 1953, long before the six year period of limitations within which to bring suit had expired.

Of the eleven questions raised in the petition (Pet. 2–3), all but question ten (treated in Argument 1, *supra*) are resolved by the ruling that the petitioners are liable under the trust fund doctrine, and a reformation of the title to the properties held in the name of Mrs. Payne and in entirety.[4] Petitioners do not attack the findings of the courts below that the transfer of one of the properties to Mrs. Payne was made with intent to defraud the creditors of Dr. Payne; nor the findings of both courts below that the properties held in entirety were purchased with funds of Dr. Payne, each resulting in insolvency. In such circumstances, there was ample basis for reformation of the respective titles rendering them subject to the

[4] There is no basis for petitioners' assertion (Pet. 3, 9-10) that the instant suit is "based upon the assessment and lien theory" as to the transferees. See complaint (R. 1-4) and opinion of the Court of Appeals (Pet. 14).

tax liens. Compare *Detroit Bank* v. *United States*, 317 U. S. 329; *United States* v. *Hutcherson*, 188 F. 2d 326 (C. A. 8th).

CONCLUSION

The decision below is correct and there is no conflict. It is respectfully submitted that the petition for certiorari should be denied.

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DECEMBER 1957.

APPENDIX

Internal Revenue Code of 1939:

SEC. 276. SAME-EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time. * * *

* * * * * *

(c) *Collection After Assessment.*—Where the assessment of any income tax imposed by this chapter has been made within the period of limitation properly applicable thereto, such tax may be collected by distraint or by a proceeding in court, but only if begun (1) within six years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer before the expiration of such six-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(26 U. S. C. 1952 ed., Sec. 276.)

SEC. 311. TRANSFERRED ASSETS.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and

proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

* * * * *

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

(b) *Period of Limitation.*—The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) In the case of the liability of an initial transferee of the property of the taxpayer—within one year after the expiration of the period of limitation for assessment against the taxpayer;

* * * * *

except that if before the expiration of the period of limitation for the assessment of the liability of the transferee, a court proceeding for the collection of the tax or liability in respect thereof has been begun against the taxpayer or last preceding transferee, respectively—then the period of limitation for assessment of the liability of the transferee shall expire one year after the return of execution in the court proceeding.

* * * * *

(26 U. S. C. 1952 ed., Sec. 311.)